

ATTACHMENT 2

DECLARATION OF CARL R. GEPPERT

I, CARL R. GEPPERT, declare that:

I am a Certified Public Accountant and a partner of Arthur Andersen LLP. My business address is 1225 17th Street, Suite 3100, Denver, Colorado 80202. Andersen Worldwide, with over 100,000 people, provides professional services to clients through member firms in 361 locations in 76 countries. It consists of Arthur Andersen ("AA") for audit, tax, business advisory and specialty consulting services and Andersen Consulting for global management and technology consulting. I am a member of a group at AA that provides audit, tax and consulting services to clients in the communications industry.

During my 19-year career, I have been almost exclusively involved in financial, regulatory and cost accounting matters in the telecommunications and utilities industries. I have served as an auditor for and consultant to clients in the telecommunications industry and currently direct my firm's telecommunications industry practice in the areas of regulatory accounting, auditing and consulting. I am our Firm's representative on the Telecommunications Subcommittee of the Public Utilities Committee of the AICPA.

PURPOSE AND SCOPE OF DECLARATION

This declaration will address certain issues for investigation raised in the Federal Communications Commission ("FCC") Notice of Inquiry¹ and the related Public Notice² released by the Common Carrier Bureau's ("Bureau") Accounting Safeguards Division ("ASD") on April 7, 1999. The Notice of Inquiry and Public Notice relate to the ASD's audit of the continuing property records ("CPRs") of hardwired central office equipment ("COE") at U S WEST, Inc. ("U S WEST" or the "Company"). The results of such audit, together with the Company's comments, were publicly released on March 12, 1999.³

Specifically, I will address the following issues raised in the Notice of Inquiry:

Issue 1: The validity and reasonableness of the statistical sampling methodologies used by the auditors, specifically the adequacy and completeness of the audit procedures performed by the ASD related to the physical verification of hardwired equipment and the propriety of the ASD's recommendations based on the results of the above audit procedures.

¹ *In the Matter of U S WEST Telephone Companies' Continuing Property Records Audit*, Notice of Inquiry, CC Docket No. 99-117, FCC 99-69 (rel. April 7, 1999), [hereinafter Notice of Inquiry]; DA 99-1072, rel. June 2, 1999; DA 99-1321, rel. July 2, 1999; DA 99-1855, rel. September 10, 1999.

² *The Accounting Safeguards Division Releases Information Concerning Audit Procedures for Considering Requests by the Regional Bell Companies to Reclassify or "Rescore" Field Audit Findings of their Continuing Property Records*, Public Notice, DA 99-668 (rel. April 7, 1999), [hereinafter Public Notice].

³ *Audit of the Continuing Property Records of U S WEST Telephone Operating Companies - As of June 30, 1997* (rel. March 12, 1999), [hereinafter Audit Report].

Issue 2: The validity and reasonableness of the methodology used by the Bureau's auditors in determining whether to re-score or to modify a finding from its field audit that equipment was "not found."

Issue 5: What accounting corrections, if any, should be used to resolve the undetailed investment identified in the audit reports.

In summary, the following key points should be highlighted:

- Sufficiency of the ASD's Audit Procedures -- the ASD's audit procedures were deficient with respect to the use of generally accepted auditing standards ("GAAS") and do not provide a reasonable basis for rendering an opinion as to the fair presentation, in all material respects, of U S WEST's COE plant investment balance. The ASD's audit procedures were inadequate and incomplete, as evidenced by the ASD's failure to conduct corroborating testing of internal controls, support documentation and other supplemental evidence, and general ledger account balances. The conclusions reached and recommendations offered by the ASD in its Audit Report cannot be relied upon - such conclusions and recommendations can only be made based on audits performed in accordance with authoritative standards and practices.
- ASD's Methodology Used to Re-score "Not Found" Items -- the ASD in its Public Notice claims that "The field audits were physical inspections conducted under generally accepted government auditing standards."⁴ The procedures followed by ASD to re-score "not found" items, however, focused only on the gathering of "probative evidence,"⁵ a restrictive and arbitrary standard, and did not take into account several aspects of generally accepted government auditing standards ("GAGAS"), deficiencies with respect to GAAS aside, necessary to render a fair evaluation of the COE account balances. Such critical deficiencies included ignoring evidential matter obtained from independent sources and the failure to review internal controls over the hardwired COE CPR process in order to properly determine the validity and reliability of the numerous types of supplemental evidence submitted to ASD by the Company.
- Accounting Corrections related to Undetailed Investment -- the Company should not write-off its balance in the undetailed investment account as this account functions as a clearing account where COE costs can be captured pending proper categorization in the CPRs. As the ASD's physical verification took place at an interim date in 1997 (June 30, 1997), a balance in the undetailed investment account

⁴ Public Notice, p. 1.

⁵ It should be noted that the term "probative evidence" is not a term commonly used by independent auditors in determining whether financial/accounting records should be modified. It appears that the ASD created this "probative evidence" standard after releasing its Audit Report.

is to be expected, to be cleared out during the annual investment categorization process.

These deficiencies, together with the deficiencies identified in the Company's complete response, show that the ASD's audit procedures, conclusions and recommendations are flawed and cannot be relied on to form an opinion on the fair presentation of the Company's COE account balances.

SUFFICIENCY OF THE ASD'S AUDIT PROCEDURES

Analysis of Authoritative Auditing Standards

Generally Accepted Auditing Standards

The ASD states in its Public Notice that the audit was conducted in conformance with GAGAS, which are claimed to be comparable to GAAS. In fact, GAGAS address the standards for auditing government organizations, programs, activities and functions, and of government assistance received by contractors, nonprofit organizations and others. Therefore, GAGAS are concerned with how the government, its agencies and other entities receiving government funds should be audited and not how a government agency performs an audit. GAGAS are not focused on how to conduct audits of the fair presentation of financial statement information, as is the case with GAAS, especially in regards to financial statements presented in accordance with GAAP.

Since the ASD draws conclusions about the fair presentation of COE plant account balances and recommends adjustments to such plant balances, such recommendations can only be made based on audits performed in accordance with GAAS.

Even if one were to assume that both sets of standards are very similar *then* the conformance to those standards must be reviewed with a critical eye. GAAS (and even GAGAS) would not sanction some of the major shortcomings of this audit in planning and execution as discussed below.

Performance of Individual Audit Procedures Such as Physical Verification

Under GAAS, audit procedures related to a specific account balance or class of transactions cannot be considered in isolation in forming a conclusion with respect to such account balance or group of transactions. This is because audit procedures performed related to other financial statement accounts might also provide evidence relative to the fair presentation of the account balance in question. For example, tests of the propriety of the balance in accounts payable may provide evidence with respect to the proper recording of both telecommunications plant and expense transactions. Such tests provide audit evidence with respect to both the debits and credits recorded in the Company's general ledger.

GAAS also require that the auditor design the audit plan "to obtain sufficient competent evidential matter to provide him or her with a reasonable basis for forming an opinion."⁶ "Evidential matter supporting the financial statements consists of the underlying accounting data and all corroborating information available to the auditor."⁷ Audit results should take into account the results of various procedures performed and evidential matter gathered. No individual audit procedure is necessarily indicative of a material misstatement in an account balance or class of transactions - other corroborating evidence must be obtained. Without such evidence, it would be inappropriate for the auditor to conclude with respect to the fair presentation of an account balance such as telecommunications plant.

Audit Evidence and Communications with Management

As noted above, GAAS require the auditor to investigate all information that he or she becomes aware of, including information provided by management, during the audit process. With respect to all information provided, the auditor must determine:

- whether the information is reliable and factual,
- if the facts existed at the date of the audit report and whether it is likely that users or likely users of the report would attach importance to the new information, and
- whether appropriate disclosures of such facts should be made to the users or likely users of the audit report. If the effect on the financial statements or auditor's report of the information can promptly be determined, disclosure should consist of issuing, as soon as practicable, revised financial statements and auditor's report.

In other words, an important source of audit evidence is Company management. As the ASD auditors were only in the field one day per central office location⁸, it is conceivable that not all assets could be located or physically verified. An audit is not a "one chance and one chance only" proposition, however. To the extent that management was able to find the sampled equipment subsequent to the auditors' field work or obtained reasonable support documentation to refute a "not found" determination, such additional evidence should be considered in the same light that the physical verification results were considered. **It is inconceivable and contrary to conventional auditing practices that the ASD staff did not perform follow-up field visits in order to verify hardwired COE that was found subsequent to their one-day visit.**

Further, to perform an effective audit, audit results should be discussed with management to ensure that the auditor has obtained the best evidence possible and reached the appropriate conclusions. AA's firmwide auditing policies require the audit

⁶ AICPA, Statements on Auditing Standards, AU Section 326: Evidential Matter, "Sufficiency of Evidential Matter."

⁷ AICPA, Statements on Auditing Standards, AU Section 326: Evidential Matter, "Nature of Evidential Matter."

⁸ The ASD auditors were attempting to locate 36 items per central office.

team to discuss preliminary findings with management and, if management presents evidence that contradicts the audit findings and can be verified, the audit team should modify the results to reflect the newly received evidence.

During the ASD's audit process, communications were extremely limited thus depriving the ASD of the benefits of management's insight and input to the audit process and results. Only upon the insistence of the Regional Bell Operating Companies ("RBOCs") were audit results released in July 1998. Even then the dialogue between the ASD and the RBOCs was limited. The RBOCs were permitted only to:

- "Comment on the specific findings addressed in the enclosed draft report and listings, limited to correction of factual errors or omissions"⁹ in response to the ASD's July Report, and
- "Provide specific comment on the enclosed audit report, limited to a total of 50 pages (including attachments, if any)"¹⁰ in response to the ASD's December Report.

This dialogue, which occurred only upon the insistence of the Company and the other RBOCs¹¹, was not the two-way communication necessary to interpret and resolve audit findings and conclusions in this complex area. It is noteworthy that at no time during the very limited dialogue was the ASD's "probative evidence" standard mentioned to the Company as the threshold that would have to be met for the ASD to "re-score" its audit results.¹²

Generally Accepted Government Auditing Standards

GAGAS does prescribe relevant standards pertaining to audit quality and the characteristics of professional and meaningful audit reports. GAGAS, codified in Government Auditing Standards,¹³ specifies the following requirements that were not followed by the ASD in conducting its CPR audits:

⁹ FCC Draft Audit Report, "Audit of the Continuing Property Records of U S WEST As of June 30, 1997, Report of Audit Findings" issued July 20, 1998 (hereinafter referred to as the "July Report").

¹⁰ FCC Draft Audit Report, "Audit of the Continuing Property Records of U S West Telephone Operating Companies As of June 30, 1997" issued December 22, 1998 (hereinafter referred to as the "December Report").

¹¹ See Letter to Ms. Kathryn C. Brown, Chief, Common Carrier Bureau from Kathleen Q. Abernathy, U S WEST, Inc. dated July 2, 1998 at Arthur Andersen attachment (Letter to Ms. Kristine M. Ringsdorf, U S WEST, Inc. dated June 26, 1998, from Carl R. Geppert).

¹² The first reference to "probative evidence" appears to be in the Public Notice, released April 7, 1999.

¹³ Government Auditing Standards: 1994 Revision, issued by the United States General Accounting Office, Comptroller General of the United States (June 1994) [hereinafter Yellow Book].

- **Requirement:** Auditors should obtain a sufficient understanding of internal controls to plan the audit and determine the nature, timing and extent of tests to be performed.¹⁴

Comment: These CPR audits consisted solely of the physical verification of certain hardwired COE items from the CPRs - the Company's internal controls over COE plant assets were not considered in determining the nature, timing and extent of audit tests to be performed.

- **Requirement:** Auditors should establish clear criteria used to determine whether audit objectives are achieved. Criteria provide a context for understanding the results of an audit. The audit plan, where possible, should state the criteria to be used.¹⁵

Comment: Despite repeated requests by the RBOCs, the ASD never disclosed its audit standards or criteria used to assess whether assets were "found" or "not found" until the release of the Public Notice on April 7, 1999 (almost one and a half years after the dates of the physical verifications and one month after the release of the Audit Report).

Standards of review must exist so that all persons conducting the audit and interpreting its results understand the criteria to determine if an item is "found" or is "not found" and the financial implications of such a finding. These standards, or guidelines, should be clearly documented and communicated prior to the execution of testing so that all parties have a common understanding of what will constitute a compliant item. If the ASD's scoring and re-scoring criteria were known in advance, as is the normal procedure in conducting an audit, the Company could have gathered additional audit evidence in accordance with such requirements. At a minimum, knowledge of the ASD's re-scoring standards would have facilitated a more efficient, if not more accurate, process of (1) physically verifying the existence of sampled items, (2) gathering additional documentation to evidence the existence of sampled COE items (by the Company), and (3) reviewing and evaluating the reliability and validity of such documentation (by the ASD).

- **Requirement:** "Auditors should report the views of responsible officials ... concerning auditors' findings, conclusions and recommendations."¹⁶ These rules go on to state that, "One of the most effective ways to ensure that a report is fair, complete, and objective is to obtain advance review and comments by responsible auditee officials and others, as may be appropriate. Including the views of responsible officials produces a report that shows not only what was found and what the auditors think about it but also what the responsible persons think about it and what they plan to do about it."¹⁷ In addition, these rules require the auditor to

¹⁴ Yellow Book, ¶ 4.21.

¹⁵ Yellow Book, ¶ 6.11.

¹⁶ Yellow Book, ¶ 7.38.

¹⁷ Yellow Book, ¶ 7.39.

evaluate management's comments on the audit findings and *modify the findings if necessary*. "When the comments oppose the report's findings, conclusions or recommendations, and are not, in the auditors' opinion, valid, the auditors may choose to state their reasons for rejecting them. Conversely, the auditors should modify their report if they find the comments valid."¹⁸

Comment: As discussed below, the ASD set a standard requiring any additional evidence to have "strong probative value equal to the physical inspection evidence."¹⁹ It is interesting to note, however, that the ASD's standards did not include the physical re-verification of assets, even though the ASD states (correctly) in the Public Notice that "the best evidence that verified whether an item was accurately recorded in the CPRs was the auditors' physical inspection during the field audits."²⁰ The obvious question that begs to be answered here is -- why didn't the ASD auditors ever go back into the field to re-verify their initial physical inspection results and/or validate the supplemental evidence as to the asset's existence provided by the Company?

- **Requirement:** "The [audit] report should be complete, accurate, objective, convincing, and as clear and concise as the subject permits."²¹ Regarding objectivity, GAGAS standards go on to state that "Objectivity requires that the presentation of the entire report be balanced in content and tone. A report's credibility is significantly enhanced when it presents evidence in an unbiased manner so that readers can be persuaded by the facts."²²

Comment: As discussed herein, there is sufficient doubt regarding the ASD's audit approach and findings. The ASD's Audit Report is neither convincing nor credible, as required by GAGAS.

Analysis of the Adequacy and Completeness of ASD's Audit Procedures

Our analysis of the adequacy and completeness of ASD's audit procedures was contained in Attachment 1 to the Company's response to the December Report.²³ This analysis incorporates much of the same material submitted in conjunction with the above U S WEST Response.

The ASD's methodologies for conducting its audits and evaluating additional evidence are detailed in the Audit Report and the Public Notice. As described in the Public Notice and the Audit Report, the ASD's primary audit procedure in attempting to assess the accuracy of the Company's CPRs was a physical inspection of sampled

¹⁸ Yellow Book, ¶ 7.42.

¹⁹ Public Notice, p. 2.

²⁰ Public Notice, pp. 1-2.

²¹ Yellow Book, ¶ 7.50.

²² Yellow Book, ¶ 7.57

²³ See Attachment 1, Declaration of Carl R. Geppert of Arthur Andersen LLP" dated January 9, 1999, to "U S WEST, Inc.'s Response to Draft Audit Findings, Audit of Continuing Property Records," dated January 11, 1999 (hereinafter referred to as the "U S WEST Response").

hardwired COE listed on the CPRs. While physical verification audit procedures often serve as an effective substantive test of the fair presentation of telecommunications plant account balances, the results of such procedures should be considered in conjunction with other audit evidence in forming a conclusion with respect to the fair presentation of plant account balances. Physical plant verification procedures must be executed carefully; however, due to the high volume of plant transactions processed in the accounting records at a company the size of U S WEST.

In performing its physical verification procedures, the ASD staff stated that its objectives were: "to determine whether U S WEST is in compliance with the Commission's requirements regarding basic property records and continuing property records, as set forth in sections 32.2000(e) and (f) of the Commission's rules, and to determine whether U S WEST's plant accounts accurately reflect the cost of assets used and useful in the provision of telecommunications services."²⁴ The ASD did not meet its objectives in several critical respects, as discussed below. These failures result in unreliable conclusions and recommendations.

- ASD statistical sampling methodologies -- the ASD used a sampling technique ("attribute sampling") that is appropriate to verify the existence of items (i.e., compliance of certain attributes with the FCC's rules) but inappropriate for use to ascertain the value of any missing items. A "variables sampling"²⁵ method designed to test investment dollars, not items, would have provided the proper basis for extrapolation of potential over- or understatement of plant account balances. If the ASD had used a variables sampling method, such a method would most certainly have involved a stratification of the population of hardwired COE investment with both a greater focus on high-dollar COE items and a greater focus on newer equipment. The ASD's sampling method, however, resulted in smaller dollar value items being as or more likely to be selected in the sample.

Unfortunately, a variables sampling method was not planned or performed by the ASD staff and cannot be applied post-facto by the ASD nor can it be overlaid upon an attribute sampling method to achieve more than one audit objective. If the ASD wanted to arrive at reliable estimates of the accuracy of plant account balances, it should have designed the audit in a significantly different fashion that considered the in-place cost of the equipment and used dollar-based selection techniques.

Since the ASD only performed a physical verification of CPR records using attribute sampling, only the objective related to the Company's compliance with the FCC's property record requirements could be satisfied. This objective would only be satisfied, however, if the audit was administered and executed properly and without bias (which it was not as explained further below). Since the ASD staff only performed a one-way verification test, such verification was biased in that it would

²⁴ December Report, p. 5.

²⁵ Variables sampling involves use of audit sampling to test the details of an account balance or class of transactions in order to obtain substantive audit evidence about the reasonableness of such monetary amounts.

only detect possible instances of CPR record overstatements. In other words, the ASD did not **plan** its audit procedures to: (1) draw a statistically valid conclusion with respect to the fair presentation of COE plant account balances, and (2) look for both potential over- and understatements of plant balances. This could only have been accomplished by planning and performing a "two-way" audit.

- No consideration for understatement -- As noted above, the ASD's physical verification procedures were solely directed at detecting instances of potential overstatement in the plant accounting records. Instances of potential understatement were not considered. In other words, the ASD's physical testing procedures would only reveal instances where COE items included on the June 30, 1997 CPRs were not in the specified location as detailed in such CPRs. A comprehensive test of the physical existence of plant assets would not only consider instances of potential overstatement, but would include procedures such as the selection of assets in the respective central offices and the tracing of such assets to the CPRs to ensure that the CPRs are not understated. Only by testing for both potential over- and understatements can one begin to form the basis for concluding as to the propriety of the telecommunications plant account balances.
- Restrictive field audit procedures -- In addition to the above flaws in the physical verification test design, the field audit procedures followed appear to have been restrictive. Per discussions with U S WEST personnel, the ASD auditors were on-site in each location for a period of one day - there were no subsequent follow-up visits to any of the 33 central office locations. Thus, Company personnel were only given a limited amount of time to locate the sampled COE items that the ASD staff was attempting to physically verify. This limited window of time seems inadequate, particularly considering the fact that certain items of COE tend to be small and "built-in" to other assets, thus making these assets difficult to find. To the extent that sampled items were physically located after the fact, Company personnel stated that the ASD staff was generally unwilling to consider such findings in their results.
- No adjustment for timing differences -- The ASD staff utilized U S WEST's CPRs related to COE as of June 30, 1997 as the population from which the sample items to be verified would be selected. The physical verification of such equipment items did not occur, however, until August and September 1997. There were no procedures performed, normally termed "cutoff procedures," to account for any plant additions, retirements, adjustments, etc. that may have occurred during the time period from June 30, 1997 to the date of the physical verification. Thus, to the extent that the ASD staff could not find equipment at the central office location during its physical verification, it is certainly possible that such plant could have been retired subsequent to June 30, 1997 but prior to August or September 1997. Classification of such items as "not found" would be clearly inappropriate in this instance.
- Failure to verify U S WEST's supplemental evidence -- In response to the ASD's July and December Reports, U S WEST personnel have supplied the ASD with supplemental information that indicated 78% of the items classified as "not found" or "unverifiable" by the ASD's physical verification team were inappropriately

classified as such. The evidence submitted by U S WEST indicated that ASD's results were inaccurate for reasons including the following: 1) assets had been physically located, 2) assets were determined to have been physically removed (but the retirement had not been reflected on the CPR) and 3) assets had been inappropriately reflected on the hardwired COE CPR, when in fact the assets were plug-in COE. In the instances that U S WEST found the CPR to be incorrect, adjustments were made to the CPR. See discussion of the validity and reasonableness of ASD's re-scoring methodology below.

- Failure to review accounting records -- Finally, it should be noted that the ASD audit concentrated only on the CPRs and not the COE plant account general ledger balances. It seems unreasonable to conclude that the Company's hardwired COE investment is overstated when the accounting records evidencing such investment were not reviewed. To the extent that adjustments had been made to the accounting records and not to the supporting CPR detail, for instance, the audit would not have detected such adjustments which obviously would impact any conclusion with respect to the fair presentation of the accounting records. The ASD further ignored the impacts of accumulated depreciation in its analyses. When looking at potential "overstatement" of assets, the net, not gross, book value is the only meaningful figure.

The ASD's recommendation that U S WEST write-off \$378.6 million of hardwired COE is fundamentally flawed. This write-off amount was determined by extrapolating the results of the ASD's sample physical verification procedures to the entire hardwired COE population. As discussed above, the sampling methodology was not designed to allow for an extrapolation of dollars. Additionally, the ASD did not correct or "re-score" its audit findings based on the supplemental evidence provided by the Company. Furthermore, the extrapolation calculation is based only on CPR items that were (in the ASD's opinion) overstated, and no consideration was given to understatements, which would impact (reduce) the extrapolation. Finally, in a statistical sample, one can only estimate errors within a range of confidence. In other words, sampling can only result in a statement such as: "I believe that the actual value of plant assets is between \$1 billion and \$2 billion with a 95% degree of confidence." Statistical theory states that no single value within such a range is any more likely to be correct than any other. Therefore, even if one assumes that the ASD's statistical methods and audit procedures were sufficient, which they were not, the lower end of the confidence interval is the only justifiable amount that can be proposed as an adjustment to the account balances, no matter what the underlying statistical methodology.²⁶ The fact that the ASD's range of precision at a 95% degree of confidence is greater than the point estimate of error (i.e., \$394.8 million versus \$378.6 million) calls into question any estimate derived using the ASD's methodology.

²⁶ "Statistical Models and Analysis in Auditing," Statistical Science, v. 4, no. 1, pp. 10-11.

ASD'S METHODOLOGY USED TO RE-SCORE "NOT FOUND" ITEMS

The ASD's audit procedures for reclassifying or "re-scoring" field audit findings were first disclosed in the Public Notice. In the Public Notice, ASD gives a lengthy explanation of its re-scoring standards, stating that:

In order to warrant a change in scoring, this additional evidence had to have strong probative value equal to the physical inspection evidence. Carriers were advised to provide adequate and convincing documentation that would make clear that the actual condition was different from what appeared to the auditor at the time of physical inspection. In response, the carriers provided a range of documentation requesting scoring changes.²⁷

There are several problems with not only the re-scoring criteria applied by the ASD but the manner by which re-scoring took place. It is no wonder that the ASD received a broad range of documentation requesting scoring changes, as the ASD never disclosed to or discussed with the RBOCs their re-scoring standards or the specific documentation needed to meet the above "probative evidence" standard. Thus, the Company and other RBOCs were left to interpret such re-scoring criteria themselves. As authoritative auditing literature does not prescribe specific evidentiary standards for the evaluation of support documentation, the Company was left with no other choice than to judgmentally evaluate the documentation accumulated and assess its reasonableness.

The ASD clearly imposed strict evidentiary standards in its review of support documentation but neglected to perform the most basic, and most persuasive, of audit procedures to verify the accuracy of such documentation and the existence of the assets in question. The auditors never returned to the field to re-verify its scoring by physical inspection or discussed the results of their scoring with the appropriate US WEST personnel. The existence of additional audit evidence should at a minimum give rise to procedures to validate such information. Such procedures cannot properly be performed "in a vacuum" by the ASD but rather must involve interaction with Company personnel where the merits of the additional audit evidence can be discussed and interpreted. This is especially necessary given the different forms of documentation maintained by the individual RBOCs, where different forms of documentation may be used differently from one company to the next in support of plant accounting entries.

The ASD's "probative evidence" standard is not a term of art in the auditing profession and prescribes a standard over and above that suggested by GAAS. GAAS addresses the concepts of sufficient, competent evidential matter as follows:

To be competent, evidence, regardless of its form, must be both valid and relevant. The validity of evidential matter is so dependent on the circumstances under which it is obtained that generalizations about the reliability of various kinds of evidence are subject to important exceptions. If the possibility of important exceptions is recognized, however, the following presumptions, which

²⁷ Public Notice, p. 2.

are not mutually exclusive, about the validity of evidential matter in auditing have some usefulness:

- a. When evidential matter can be obtained from independent sources outside an entity, it provides greater assurance of reliability for the purposes of an independent audit than that secured solely within the entity.
- b. The more effective the internal control, the more assurance it provides about the reliability of the accounting data and financial statements.
- c. The independent auditor's direct personal knowledge, obtained through physical examination, observation, computation, and inspection, is more persuasive than information obtained indirectly.²⁸

The independent auditor's objective is to obtain sufficient competent evidential matter to provide him or her with a reasonable basis for forming an opinion. The amount and kinds of evidential matter required to support an informed opinion are matters for the auditor to determine in the exercise of his or her professional judgment after a careful study of the circumstances in the particular case. However, in the great majority of cases, the auditor has to rely on evidence that is persuasive rather than convincing...even an experienced auditor is seldom convinced beyond all reasonable doubt with respect to all aspects of the statements being audited.²⁹

Several key concepts from the preceding excerpts should be highlighted. First, GAAS recognizes that the nature and extent of audit evidence will vary among audits and that proof "beyond a reasonable doubt" will rarely be obtained. Thus, the ASD's "probative evidence" standard in the real world will rarely, if ever, be achieved. What GAAS (as well as GAGAS) then directs the auditor to do is obtain additional persuasive evidence - not ignore the documentation supplied because it doesn't meet, in the ASD's interpretation, this arbitrarily high standard.

Second, GAAS recognizes that many different types of evidence are available to the auditor. While some types of evidence are more reliable or persuasive than other types, all evidence should be considered and appropriate steps taken to validate such evidence in support of the audit opinion rendered. GAAS speaks to the auditor's ability to build a reasonable, persuasive case in order to positively opine with respect to the fair presentation of an account balance, rather than evaluate evidence against an artificially high standard in order to produce negative findings.

²⁸ AICPA, Statements on Auditing Standards, AU Section 326: Evidential Matter, "Competence of Evidential Matter."

²⁹ AICPA, Statements on Auditing Standards, AU Section 326: Evidential Matter, "Sufficiency of Evidential Matter."

Third, the ASD cites criterion c. above in the Public Notice in its discussion of the evidence gathered in these CPR audits. However, the ASD largely ignored criteria a. and b. above in performing its audits and evaluating supporting documentation submitted by the companies. With respect to criterion a. above, AA performed tests of physical verification and support documentation at three sampled U S WEST offices - the results of such testing are summarized below.

Further, the ASD did not review internal controls over the hardwired COE CPRs in order to determine the nature, timing and extent of audit testing to be performed. In addition, the ASD didn't develop a proper understanding of the COE internal control environment in order to provide the basis for the evaluation of specific audit evidence and audit results. A review of internal controls not only could have influenced the nature and scope of audit testing procedures performed by the ASD in its audit, but it would have provided the ASD a sound basis for accepting or rejecting various types of supporting documentation supplied by the companies. For example, had the ASD reviewed the controls over U S WEST's retirements process, including key systems used in the retirement of COE assets, and found them reliable, then reliance on computer generated documentation of COE retirements as valid supporting documentation would clearly have been justified. By failing to review internal controls over COE-related processes, the ASD failed to justify any standard for review of support documentation.

As discussed above, many deficiencies were noted with respect to ASD's compliance with GAGAS, which standards were supposedly followed by ASD in performing its audits and evaluating additional support documentation. Standards of review must exist so that all persons conducting the audit and interpreting its results understand the criteria to determine if an item is "found" or is "not found" and the financial implications of such a finding. These standards, or guidelines, should be clearly documented and communicated so that all parties have a common understanding of what will constitute a compliant item. If the ASD's scoring and re-scoring criteria were known in advance, as is the normal procedure in conducting an audit, the Company could have had the opportunity to gather additional audit evidence in accordance with such requirements. Additionally, the Company could have provided documentation and/or explanations along with the evidence submitted in order to prove that such evidence was "probative" in nature. At a minimum, knowledge of the ASD's re-scoring standards would have facilitated a more efficient, if not more accurate, process of both gathering additional documentation to evidence the existence of sampled COE items (by the Company) and reviewing and evaluating the reliability and validity of such documentation (by the ASD).

As a result, ASD's re-scoring standards and methodology were deficient with respect to the timing of their communications to the auditee, the restrictive and arbitrary use of the "probative evidence" standard, the disregard of pertinent authoritative standards for the determination of sufficient and competent evidential matter, and the failure of ASD to review internal controls in order to determine what evidence could be relied on. Such deficiencies render the re-scoring process and the audit results determined therefrom unreliable.

In May 1999, AA visited three Colorado central offices included in the ASD's sample to (1) test the reasonableness of ASD's evidentiary standards described above, and (2) attempt to re-verify COE items that ASD scored "not found" or "unverifiable." In most instances, U S WEST claimed to have physically located such items subsequent to the ASD's field audit and/or submitted supporting documentation as evidence of those items' existence. The results of AA's re-verification efforts are summarized as follows:

<u>Central Office</u>	<u>Status per ASD</u>	<u>Status per AA</u>
Loveland	7 Not Found/ Unverifiable	2 Found 2 Mobile units improperly sampled 2 Retired 1 Not Found
Smoky Hill	6 Not Found/ Unverifiable	1 Found 2 Partially Found 3 Retired
Colorado Springs	7 Not Found/ Unverifiable	2 Found 3 Retired 1 Mobile unit improperly sampled 1 Not Found

As can be seen above, AA was able to verify the physical existence of five sampled CPR items that the ASD had scored "not found" or "unverifiable" and partially found two other sampled items. U S WEST had accounted for eight additional sampled items by retiring such assets subsequent to the ASD's physical verification. Lastly, we noted that three of the sampled items actually represented mobile equipment that should not have been sampled by ASD during this hardwired COE verification. Prior to the release of the ASD's Audit Report, the Company provided information to the ASD that indicated certain items scored as "not found" or "unverifiable" by the ASD had, in fact, been found. AA's testing should demonstrate that the ASD's audit results are flawed and that the ASD was remiss in its responsibility to follow-up on the information provided by the Company.

UNDETAILED INVESTMENT

The ASD has recommended that U S WEST write-off the balance in the undetailed investment account as of June 30, 1997. The Company should not record this write-off. The undetailed investment category is used as a repository to store capitalizable costs until they can be recorded in the proper categories within the detailed continuing property record ("DCPR") system. Amounts included in the undetailed category are recorded in the proper general ledger plant account, in the proper vintage year and wire center, but are awaiting the necessary detail to assign the appropriate equipment CPR number. Just because there is a balance in this CPR category at an interim date within 1997 does not mean that the dollars recorded therein are erroneously recorded.

Each year, U S WEST performs an activity called the "annuals process." This process is performed in order to properly categorize the dollars recorded in the undetailed investment category in the CPRs. The dollars were originally recorded in undetailed investment because certain data elements were not present at the time the COE was originally recorded; therefore, the equipment could not be recorded in the DCPR in the final category. This process is perfectly reasonable for U S WEST to follow, as it is consistent with the FCC's prescribed use of clearing accounts in Part 32 of its Rules and Regulations. These clearing accounts are used in order to hold dollars until their final accounting can be properly determined. The use of clearing accounts is common practice by virtually every company in every industry. The undetailed investment category is in essence the "clearing account" maintained within the CPRs.

In addition, U S WEST has informed us that certain nonregulated plant is tracked in the undetailed investment account for administrative ease. These dollars, which totaled approximately \$106 million, were inadvertently included in the amount disclosed to the ASD as of June 30, 1997. These amounts should not have been included in the ASD's recommended write-off. U S WEST provided evidence to the ASD prior to the release of its Audit Report that nonregulated plant was improperly included in the undetailed investment amount disclosed to the ASD, but the ASD failed to recognize this evidence and reduce its recommended write-off accordingly. The fact that the Company chooses to track nonregulated plant in the undetailed investment account is strictly a business decision and in no way should be deemed as erroneous accounting.

As of June 30, 1997, U S WEST had approximately \$219 million in the undetailed investment account. Based on information provided to AA by U S WEST, as of December 1998, U S WEST had cleared all but \$1.7 million of the original June 30, 1997 undetailed investment (not including the nonregulated plant discussed above) to the proper DCPR accounts. By August 31, 1999, the balance in the undetailed investment account was approximately \$23 million (including certain nonregulated plant investment), thereby demonstrating the fluctuating nature of this account. Thus, at the current time, there are no regulated COE investment dollars from June 30, 1997 in the undetailed investment account to write-off and the ASD's recommendation should be rejected.

CONCLUSION

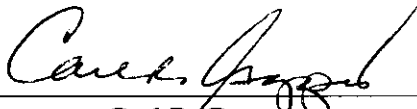
In summary, the ASD's limited physical verification audit procedures were not sufficient to form an opinion, in accordance with GAAS, as to the fair presentation of the Company's hardwired COE plant investment. ASD's reliance on GAGAS was both misstated and narrowly selective and is insufficient to compensate for those provisions of GAAS not used in the audit plan or execution. Specifically, ASD's failure to conduct corroborating testing of internal controls and ledger account balances and their failure to completely and consistently evaluate the significant evidential matter submitted by the Company and external sources, including Arthur Andersen, together with previously identified audit deficiencies, render the audit findings, conclusions and recommendations unreliable. Additional quality control procedures over the physical verification tests that were performed as well as additional compliance and/or

substantive audit procedures would be necessary to render an opinion on the fair presentation of U S WEST's COE account balances pursuant to GAAS.

This concludes my declaration.

Pursuant to 47 C.F.R. Section 1.16, I declare under penalty of perjury that the foregoing is true and accurate to the best of my knowledge and belief.

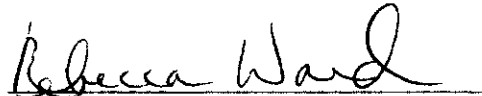
Executed this 23rd day of September 1999.



Carl R. Geppert

CERTIFICATE OF SERVICE

I, Rebecca Ward, do hereby certify that on this 23rd day of September, 1999, I have caused a copy of the foregoing **COMMENTS OF U S WEST COMMUNICATIONS, INC.** to be served, via hand delivery, upon the persons listed on the attached service list.


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